QUARTERLY REPORT Oct. 1976

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Executive Office of the

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COUNCIL ON WAGE and PRICE STABILITY

Executive Office of the President Washington, D.C.

No. 8

EXECUTIVE OFFICE OF THE PRESIDENT
COUNCIL ON WAGE AND PRICE STABILITY
726 JACKSON PLACE, N.W.
WASHINGTON, D.C. 20506

The President
The White House

Dear Mr. President:

Enclosed is the eighth quarterly report on the activities of the Council on Wage and Price Stability, as required by Section 5 of the Council on Wage and Price Stability Act. This report covers the Council's operations during the three-month period, July 1976 through September 1976.

The first chapter of the report lists this quarter's activities in chronological order. Chapter II elaborates on the background and content of the Council's studies, reports, testimony, and filings released during the third quarter of 1976. The studies currently in progress are previewed in Chapter III; many of these will be completed and reports on them released during the final quarter of 1976.

During the third quarter, the Council has continued to evaluate and comment on the economic impact of government agency actions, attempting to assist agencies in weighing the benefits of their proposals against the public and private costs that might be incurred thereby. In a broader context, the Council's concern with the public sector extends to its current study of the impact of federal regulation on the private sector and to an evaluation of the Inflation Impact Statement program.

The Council's studies in the private sector have produced reports this quarter on prices in the aluminum and the chlorine, caustic soda industries, as well as on wage movements in several major industries. Special emphasis is being given to the problem of rising health care costs and to ways of reducing the costs of employee health benefit programs; a report was issued this quarter

on the Council's preliminary findings on this subject. In its continuing interest in industrial price behavior, the Council is not only evaluating particular price increases but also the industry-specific factors that shape past, present, and future price movements.

The Council will continue to pursue these and other similar activities in the coming quarter, and it will call your attention to wage and price developments that are of interest.

Respectfully,

William E. Simon
Chairman

L. William Seidman
Deputy Chairman

William Lilley III
Acting Director

TABLE OF CONTENTS

COUNCIL AUTHORITY

Congress created the Council by enactment of the Council on Wage and Price Stability Act on August 20, 1974 (Public Law 93387) This Act, which contained an expiration date of August 15, 1975, was amended and extended until September 30, 1977, by Congress' enactment on August 9, 1975, of the Council on Wage and Price Stability Act Amendments of 1975 (Public Law 9478, signèd on August 9, 1975). The text of the Act, as amended, is set forth in Appendix B.

It is the Council's responsibility under the Act, to monitor and analyze inflationary activities throughout the economy. In the private sector, the Council examines price and wage activities for inflationary impact. The Council conducts comprehensive studies of certain major industries as well as investigations of specific price or wage increases as they are announced. These investigations are intended to discover whether price increases are warranted by cost or demand considerations. In some instances, the Council has held public hearings to gather data and has issued public reports of its findings. Where the Council has found a wage or price increase to be inflationary, it has issued public statements of its findings and, on occasion, has requested a delay or a reduction in the increase.

The Council also reviews the activities and programs of the departments and agencies of the Federal Government to discover whether they have any inflationary impact. It does this in two ways. First, pursuant to Executive Order 11821 and OMB Circular A107, the Council reviews the "inflation impact" analyses that the Executive branch agencies are required to make of proposed rules and regulations that would have a "major" economic impact. Second, with respect to the independent regulatory agencies as well as the Executive branch agencies, the Council, pursuant to its statute, "review(s) and appraise(s) the various programs, policies, and activities of the departments and agencies of the United States for the purpose of determining the extent to which those programs and activities are contributing to inflation; and intervene(s) and otherwise participate(s) on its own behalf in rulemaking, ratemaking, licensing and other proceedings before any of the departments and agencies of the United States, in order to present its views as to the inflationary impact that might result from the possible outcomes of such proceedings."

The Council has no legislative authority to impose mandatory controls on prices, wages, and interest, rents, profits, dividends or other payments, nor has it the authority to prevent or delay any federal agency action.

CHAPTER I

THE QUARTER AT A GLANCE

The following chronology highlights activities of the Council on Wage and Price Stability during the second quarter of 1976. Chapter II elaborates on the background and content of many of these actions. The numbers appearing in parentheses below refer to the Council press release dealing with these actions.

July 9: The Council filed comments before the Federal Energy Administration criticizing FEA's proposed regulations to implement a program of financial assistance to the states in support of their energy conservation plans. (CWPS-170)

July 20-21: The Council held the second of its series of three hearings on rising health care costs. The hearings were held in Chicago, and the views of representatives from the health care industry, private firms, unions, and private citizens were heard. (CWPS-171)

July 20: Council Assistant Director, James C. Miller III, addressed the National Conference on Care Labeling with regard to the Federal Trade Commission's proposed revision of the care labeling rule.

August 3: Council Acting Director William Lilley III, in testimony before the Secretary of Transportation, recommended that further research be undertaken on the comparative effectiveness of DOT's "air bag" proposal. (CWPS-174)

August 4: The Council and the Office of Management and Budget announced that they were undertaking an appraisal of the Inflation Impact Statement program. Interested parties were invited to submit comments on the program by August 30, 1976. (CWPS-175)

August 6: The Council filed comments before the Occupational Safety and Health Administration criticizing OSHA's proposal requiring field sanitation facilities for agricultural workers. (CWPS-176)

August 9: The four major automobile manufacturers were asked to submit cost, profit, and sales data to the Council for use in its analysis of 1977 automobile prices. (CWPS-177)

August 10-11: The Council held its final hearing in its first series of three on rising health care costs. The hearing was held in San Francisco. (CWPS-172)

August 17: William Lilley III, Acting Director of the Council, and Thomas Lenard, Senior Economist, in a statement to the Consumer Product Safety Commission, expressed the Council's view that CPSC's stated policy for establishing priorities was a significant improvement over previous practice. (CWPS-178)

August 23: The Council released a Staff Report on its study of chlorine, caustic soda prices.

August 25: The Council submitted comments to the Department of Agriculture supporting the USDA's proposal to revise the definition of meat to include products obtained using certain mechanical deboning procedures. (CWPS-180)

September 8: The Council held a public meeting to discuss preliminary drafts of a report on the economic impact of federal regulation of the domestic iron and steel industry. The drafts are the product of a joint study being conducted by the Council and the National Center for Productivity and Quality of Working Life. (CWPS-179)

September 13: The Council filed comments with the Interstate Commerce Commission urging it to revise its most recent proposal for defining "market dominance" under the Railroad Revitalization and Regulatory Reform Act of 1976. (CWPS-182)

September 14: The Council's Assistant Director, James C. Miller III, testified before the Occupational Safety and Health Administration, urging OSHA to modify its proposed standard for worker exposure to inorganic arsenic. (CWPS-183)

September 14: The Council filed comments before the Department of Health, Education and Welfare suggesting alternative procedures and additional measures that might improve HEW's proposed regulations aimed at eliminating discrimination toward handicapped persons. (CWPS-184)

September 16: Council Acting Director, William Lilley III, testified before the Subcommittee on Economic Stabilization of the U.S. House of Representatives Committee on Banking, Currency and Housing. Mr. Lilley's testimony summarized the Council's role and activities in monitoring inflationary developments in the public and private sectors of the economy. (CWPS-185)

September 17: The Council, as part of its continuing study of rising health care costs, released a report covering six case studies of innovative union and employer programs to control these costs. The report also included a compendium listing another 119 similarly-aimed projects with information sources for each. (CWPS-186)

September 22: The Council testified before the Occupational Safety and Health Administration, asking OSHA to reevaluate its proposals dealing with the issue of noise in the workplace. (CWPS-187)

September 23: The Council filed comments before the Department of Housing and Urban Development regarding Federal financial assistance for new communities. (CWPS-188)

September 24: The Council released its analysis of the 1976 collective bargaining settlements in the trucking, electrical equipments, and rubber industries. (CWPS-189)

September 24: The Council released its Staff Report, Aluminum Prices, 1974-75. (CWPS-190)

September 24: The Council filed comments before the Federal Trade Commission suggesting several revisions of FTC's proposed rules on permanent care labeling of textile products. (CWPS-191)

September 27: The Council announced that in October it would hold a second round of three hearings on rising health care costs. Hearings in this series will take place in Philadelphia on October 14, in Houston on October 21, and in Miami on October 28. (CWPS-192)

September 29: The Council filed its recommendations before the Interstate Commerce Commission concerning ICC's proposal to change regulations which will expedite the development of trucking services in cases where common or contract carriers take over services of a private carrier wishing to hire outside firms. (CWPS-193)

CHAPTER II

MONITORING INFLATIONARY INFLUENCES

The Council's responsibility to identify and analyze inflationary influences in the economy extends to both the public and the private sector. Under the direction of James C. Miller III, the Council's Office of Government Operations and Research is concerned with examining the possible inflationary effects of federal regulatory policies. Inflationary influences in the private sector are monitored by the Council's Office of Wage and Price Stability, under the direction of Robert W. Crandall. All of the Council's wage and price studies in the private sector and its filings and other actions in the public sector are available to the public. A list of them may be found at Appendix D.

MONITORING FEDERAL ACTIONS

The Council's role with regard to public sector activities is essentially to act as a watchdog against any inflationary consequences these actions might have. While it cannot block actions by other government agencies, the Council's inflationary impact findings are made available to the agencies and the public by filing comments with the agency or by testifying in open hearings. In addition, the Council regularly reviews the Inflation Impact Statements that executive branch agencies are required tc make for proposed rules and regulations which are considered "major." (See Appendix C).

In carrying out its oversight role, the Council reviews proposed government actions, and examines the costs and benefits of alternative actions. When the benefits of a proposed regulation appear to exceed its costs, that regulation may not be inflationary; if the costs exceed the benefits, it is considered inflationary. A related criterion employed by the Council is that the "cost" of a regulation may be the foregone opportunity of adopting a better regulation. Therefore, to the extent that the goals of a proposed regulation could be achieved in a more efficient, less costly manner than the method which the regulation contemplates, that regulation is, in a real sense, inflationary.

The Council also believes that the same criteria should be used to reassess existing rules, regulations, and standards in the light of changing economic circumstances. In addition, agencies

are encouraged to make full use of their administrative discretion in the timing of their actions if, by so doing, short-run inflationary pressures could be eased.

The actions of the Council this quarter that concern the federal sector are summarized below. A summary of all previous public sector activities may be found in the Council's Quarterly Report for April-June, 1976.

Food and Drugs

On August 25, the Council filed comments before the U.S. Department of Agriculture concerning the Department's proposal to revise the definition of "meat" and to provide for nutritional standards, uses and labeling of certain classes of meat. This proposal would expand the definition of meat to include (a) products obtained using recently developed mechanical deboning standards, and (b) such products as fatty trimmings and rendered tissue products meeting certain standards. In addition, the proposal specifies classes of meat which can be used as ingredients in various categories of finished products.

Because mechanical deboning increases the meat yield per carcass, the Council felt that permitting the use of this technique would increase the variety and supply of meat products and thus exert downward pressure on consumer meat prices. The Council also urged that health and safety questions regarding the use of mechanical deboning be resolved before a final decision is reached, and it suggested that a labeling requirement might be in order.

The Council did not have sufficient information to reach a conclusion with regard to the nutritional standards for products to be newly defined as meat. However, it suggested that if these products were labeled as to nutritional value, and if the nutritional variation were reflected in price differences, consumers might benefit from the wider range of choice in meat products. The Department was urged to compare the net benefits of using standards, labeling, or some other alternative approach with respect to the nutritional content of deboned meat.

Transportation

Railroads

On September 13, the Council commented on the Interstate Commerce Commission's most recent proposal regarding a definition of "market dominance." Under the recently passed Railroad Revitalization and Regulatory Reform Act (4R Act) of 1976, maximum rates charged by railroads would be governed by competitive market forces except in those cases where the Commission determines that a railroad possesses "market dominance;" in these cases, ICC may intervene in the rate-setting procedure. Under the Act, ICC is to establish standards for determining market dominance, and the Council's comments were directed towards the standards proposed.

The Council had previously filed comments on this matter on April 15, 1976. At that time, the Council felt that ICC's proposal for determining market dominance would result in control over the vast majority of rates, thus defeating the intent of the 4R Act to decrease regulation of the rail industry. The Council suggested a variety of factors that should be considered in balancing the need for intervention in significant cases with that of maintaining a relatively competitive environment in the industry.

Under the ICC's latest proposal, there would be a rebuttable presumption that a carrier possesses market dominance where either (1) the carrier has handled 70 percent or more of the traffic during the preceding year, or (2) the rate in issue exceeds the variable costs of providing the service by 60 percent or more, or (3) affected shippers or consignees have made a substantial investment in rail-related equipment which makes the use of another carrier or transport mode infeasible. If a carrier is found to have market dominance, the ICC would conduct a hearing to determine whether the rates charged were "just and reasonable." However, in more complex situations, the Commission would judge market dominance on a case-by-case basis.

The Council felt that adopting these regulations would -- like those previously proposed -- give ICC _carte blanche_ to continue its detailed supervision of railroad rates. With regard to the specific standards, the Council felt that:

1. Nonrail modes of transportation should be considered in measuring market shares for application of the "70 percent test."

2. The choice of cost standard should be very carefully reviewed insofar as the standard chosen -- percent of variable cost -- represents a reduction in the degree of allowed price flexibility.

3. The "locked in" position of one shipper cannot define the structure of the entire market and is therefore not relevant to a finding of market dominance.

The Council also noted that even if these standards were valid tests of market dominance, the Commission has left itself free to ignore them in specific cases of its own choosing. The Council recommended that more relevant tests of market dominance be developed and that these tests be the sole determinant of a finding of market dominance.

Trucking

On September 29, the Council supported a petition before the Interstate Commerce Commission by Herman Brothers, Inc., a trucking company. The petition requested the adoption of expedited procedures in certain cases in which common or contract carriers wish to take over from private carriers. Under current regulations, only truckers authorized to serve a specific firm may compete for its business. Other carriers wishing to provide services must first obtain an ICC certificate or permit by proving the need for such service and the inability of existing common and contract carriers to provide it. This has been a lengthy and highly uncertain process.

The petition under consideration was enthusiastically endorsed by the Council. Although it was pointed out that the measure provided no substitute for regulatory reform, the Council felt that it would lower consumer prices by expanding opportunities for competition and that it would reduce the number of empty backhauls, thus conserving fuel and other resources. In addition, the Council urged the Commission to consider two further modifications to the proposal: (1) that a permanent, rather than temporary, certificate be granted upon initial approval of the application of the common or contract carrier, and (2) that this procedural reform not be limited to the trucking of bulk commodities.

Health and Safety

Occupational Safety

On August 6, the Council commented on the Occupational Safety and Health Administration's proposed standard requiring sanitation facilities for agricultural workers in the field. The basic features of the proposal require providing potable water and toilet and hand washing facilities within a five-minute walk of the place of work; field food service, if provided, must be hygienic. First year costs of the standard to agricultural producers were estimated to range between $7.8 million and $15.75 million, with much lower costs in subsequent years. The benefits of the proposal are largely cultural and health-affecting, and they were not quantified.

The Council was concerned that the regulations may not represent the least costly method of achieving the general objectives. It also felt the proposal was not sufficiently flexible to accommodate differences in working conditions, in health standards for food and nonfood production, and in continuity of operation; for this reason, the Council suggested that state and local regulation might be more suitable.

On September 14, the Council commented on a standard proposed by the Occupational Safety and Health Administration for exposure to inorganic arsenic of workers in smelters, herbicide producing plants, wood preserving plants, and others. The proposal would require the installation of engineering controls to reduce the maximum exposure level from the present 0.5 milligrams of arsenic per cubic meter of air to 0.004 milligrams.

OSHA estimated that the proposal would result in additional capital costs of $273 million and annual operating costs of $56 million; it also estimated that between 350 to 380 additional workers would be required. The Council questioned the accuracy of the cost estimates submitted, and pointed out that the burden of compliance would fall disproportionately on smaller firms, leading to a possible reduction in competition in some industries.

The estimate of benefits in terms of worker lives was based on only five epidemiological studies of very small populations subjected to arsenic exposure levels considerably in excess of the proposed standard. The Council staff suggested an alternative method of estimating excess deaths among arsenic-exposed workers which indicated that from 12-106 worker lives might be saved by the new requirements.

However, the wide range of this estimate, coupled with the difficulty in assigning monetary value to lives saved, made it difficult to determine whether the proposal would be noninflationary in terms of producing net benefits.

The Council urged OSHA to consider and compare the costs and benefits of respirators, protective garments, and revised work practices as an alternative to engineering controls. It also suggested that, in view of the higher cost of retrofitting old plants, engineering controls might be required for all new plants, while old plants might be allowed to rely on personal protection programs.

In conclusion, the Council recommended that OSHA develop more extensive data on the relationship between exposure to arsenic and respiratory cancer before altering the present standard and requiring engineering controls. As an interim measure, the Council recommended the use of personal protective clothing and revised work practices.

On September 22, the Council released its testimony before OSHA concerning a proposed standard for reducing the risk of hearing loss of employees exposed to noise in the workplace for prolonged periods. OSHA initially put forth this proposal on October 24, 1974. It included a continuation of the current 90 dBA standard until the practicality and necessity of an 85 dBA standard might be indicated; it also provided for engineering controls of noise exposure wherever feasible and for monitoring and recordkeeping with respect to noise exposure, as well as testing of workers to high noise levels.

On March 21, 1975, the Council filed comments on a request by the Environmental Protection Agency that OSHA lower its standard for noise exposure from 90 dBA to 85 dBA. Noting that cost estimates for achieving the 85 dBA level ranged as high as $32 billion, the Council urged the agencies to jointly sponsor a study of all relevant costs and benefits associated with a lower noise standard. The Council also recommended that alternative methods of noise protection be considered. This position was reaffirmed by the Council in testimony before OSHA on June 25, 1975.

The Council's September testimony was addressed to OSHA's economic impact assessment of the benefits, costs, and alternatives of the proposed standard. OSHA listed as benefits of the standard a reduction in hearing impairment among workers, reductions in workmen's compensation premiums, reductions in occupational injuries and absenteeism, and improvements in productivity; quantitative estimates were presented for the first two benefits only. Capital costs of complying with the 90 dBA standard through engineering controls

were estimated to be $10.5 billion, with annual maintenance costs amounting to 5 percent of capital costs, and monitoring and record-keeping costs amounting to $155 million per year. The standard would affect about 13 million workers, and additional costs -- for audiometric testing and hearing conservation programs -- would amount to about $30 per worker per year.

The Council was concerned that the OSHA analysis did not allow direct comparison of costs and benefits at different levels of control. It supplied a cost-effectiveness comparison which eliminated noncost-effective options, and it attempted to quantify nonhearing loss benefits in order to allow choice among the remaining options. The Council's conclusion was that some variant of a hearing protector standard, rather than an engineering standard, was likely to be the most cost-effective, and therefore the most anti-inflationary solution. It also suggested methods for examining other alternatives using the cost-effectiveness criterion such as different standards and/or compliance provisions for different industries depending upon cost-effectiveness criteria. OSHA was urged to pursue this analysis before promulgating a final standard.

Consumer Safety

On August 3, the Council's Acting Director, William Lilley III, testified before the Secretary of Transportation and submitted a statement detailing the Council's views on proposals regarding crash protection for automobile occupants. The Secretary was concerned with choosing among five alternative plans: continuation of present protection requirements, mandatory safety belt laws, a federal test of passive restraint devices ("air bags"), mandatory passive restraints, and a mandatory passive restraint option for states.

The Council had commented previously on a proposal for mandatory passive restraints. In 1975, Council officials testified before the Senate Consumer Subcommittee of the Committee on Commerce and before the Administrator of the National Highway Traffic Safety Administration. The Council's position was that the air bag appears promising but that more testing should be done before a determination is made on whether it should be mandated on a broad scale, since costs appeared to be large while benefits were uncertain. The Council thought such a regulation could well be inflationary. It recommended a federally sponsored field test in order to obtain relevant information.

In its present statement, the Council commended the Department on the quality of its cost/benefit analyses of alternative protection measures. However, it felt that a comparison of net benefits would be more relevant, and it submitted such a comparison. The Council also noted that relative benefits estimates are highly dependent on assumed rates of seat belt usage and recommended that efforts be made to increase such usage. In addition, the Council reaffirmed its 1975 recommendation that passive restraint systems be given wider field tests to determine their effectiveness, and it suggested several ways of conducting such tests. The Council concluded that, without further evaluation, a mandatory air bag restraint requirement would be premature.

On August 17, Council Economist Thomas M. Lenard testified before the Consumer Product Safety Commission's Product Safety Advisory Council. In a policy statement of July 8, 1976, the Commission had set out new criteria it will apply in establishing priorities for actions that affect public safety. Two of the criteria involve estimating the expected benefits of Commission actions, and a third would assign a higher priority to those risks which can be reduced at lower cost. The Advisory Council's hearings were to consider these policies.

The Council on Wage and Price Stability has had a continuing interest in this matter. In letters to the Consumer Product Safety Commission on October 2, 1975 and again on January 9, 1976, the Council was critical of CPSC's method of determining priorities and of analyzing priority items and suggested that CPSC use a cost-benefit framework for establishing priorities.

During the current hearings, Acting Council Director William Lilley III, commented that the recent CPSC policy statement on establishing priorities showed significant improvement; Mr. Lenard's testimony suggested that a net benefit criterion would be the most appropriate method of establishing the order of CPSC action. The Council also indicated that benefit estimates might be improved by more careful weighting of the injury severity index, and it urged the Commission to explore more fully the cost and benefits of regulations which increase the flow of consumer information as an alternative to standard setting.

Energy

On July 9, the Council criticized guidelines proposed by the Federal Energy Administration to implement a program of financial assistance to the states in support of their energy conservation plans.

The guidelines, required by the Energy Policy and Conservation Act, would be used to allocate federal funds among participating states in 1977 and 1978. State eligibility under the proposed regulations would depend upon submission of a detailed state energy conservation plan which would include, among other items, a 5 percent reduction in energy consumption from the projected level for that year, estimates of costs and energy savings resulting from the program, and certain specific minimum programs and standards to promote energy efficiency. Funds will then be distributed among states whose plants are approved according to formulas based on population, on estimated energy savings, and on participation in the program. The minimum programs and the formulas for distribution of funds are left to FEA's discretion.

The Council's review concluded that the ultimate impact of the FEA proposal had not been sufficiently analyzed. The Council noted that FEA acceptance of a state plan would be based solely on a benefit criterion related to energy savings. It suggested that plan acceptance and fund allocation formulas should be based on a net benefit criterion in order to maximize energy use efficiency and to minimize the inflationary impact of the program. The Council felt that the FEA analysis probably underestimated both costs and benefits, and it urged that methods of estimating costs and benefits of state energy conservation plans be improved.

Banking and Credit

On September 23, the Council filed comments before the Department of Housing and Urban Development criticizing its proposal to extend approximately $500 million in loan guarantees to currently approved new community projects. Although HUD was not required to file an Inflation Impact Statement with regard to these rules, the Council expressed concern that possible costs associated with the proposed debt guarantees far outweighed benefits, which -- if existent -- are at best nebulous in nature.

Benefits listed by HUD for new communities include greater satisfaction to residents; increased efficiency in transportation, utility usage, and reduction of pollution; opportunity to achieve greater economic and racial integration of housing; opportunity for innovation in construction and urban design; and several indirect benefits to residents in other communities in the area. However, a HUD evaluation of these factors did not indicate any clear superiority of federally-assisted new communities over others.

With regard to costs, the Council pointed out that lower interest rates to developers using federally-guaranteed funds might well be offset by higher administrative costs; it also noted that some loss is associated with the distortion of free market responses. The Council urged that HUD concentrate its efforts on new communities proposed and undertaken by private developers.

Other Actions

Opportunities for Handicapped

On September 14, the Council commented on proposals by the Department of Health, Education and Welfare designed to eliminate discrimination on the basis of handicap from all programs and activities funded by HEW. The proposed rules would affect employment practices; program accessibility; preschool through postsecondary education; and health, welfare, and social services. The Council's comments were confined to the first three areas.

With regard to employment, the Council felt that employment opportunities for the handicapped would be expanded if the costs of administering special programs for the handicapped were kept at a minimum. The Council recognized the difficulty of measuring psychic benefits of such programs and commented that pecuniary benefits offered to handicapped workers might have to be larger than for other workers because of the possibility that state and local disability benefits reduce the incentive for employment; this might result in discrimination against nonhandicapped workers. On the cost side, the Council pointed out that the cost of adjustment varies with the type of handicap and thus might fall disproportionately among employers. Further, because less costly changes tend to be made first, estimates of ultimate cost are probably understated. Finally, the Council suggested methods of cost-benefit analysis for individual components of the regulations.

With regard to regulations affecting the schools, the Council pointed out that existing legislation already imposes some accessibility requirements and that benefits associated with improved accessibility are difficult to quantify. However, cost and benefit estimates indicate that there are declining average costs associated with increased service to handicapped children in schools; this implies that greater cost-effectiveness will result when more students are served in a prepared facility. Therefore, the Council felt that net benefits would be greatest if special handicaps were directed toward specialized schools, rather than servicing all

handicaps in all schools. The Council was critical of the welfare aspect of the proposed regulation with regard to handicapped school children and urged that alternative approaches be explored.

The Council suggested a method of accounting for costs of accommodating handicapped students in post secondary schools, and it again urged specialization in type of accommodation. Students with a particular handicap could be directed toward suitable schools. In addition, existing universities could be rated as to their current capabilities for accommodating specific types and levels of handicap. In conclusion, the Council suggested that choice of school for the handicapped not be limited by district or state lines so that program costs could be reduced through school specialization.

Care Labeling

On September 24, the Council filed recommendations for modifying the revised rules on permanent care labeling of textile products proposed by the Federal Trade Commission. Under these rules, care labels specifying laundering and cleaning techniques must be permanently attached by manufacturers. The proposed revisions would extend this requirement to include household furnishings, carpets and rugs, and intermediate textile products. In addition, the proposed rules give detailed requirements regarding the nature of care instructions, provide definitions of terms, and describe specific conditions for exemption and waivers of the regulation.

In the view of the Council, because consumer requirements for care information vary -- institutional or bulk buyers, for instance, have less need for labels on each item than do individual customers -- a single standard imposes some unnecessary costs. The competitive nature of the testile industry might be expected to tailor care labeling to the needs of specific groups of buyers and thus reduce overall costs. In addition, less costly methods of providing care information may be sufficient for specific buyers.

The Council recommended several alternatives to the FTC proposal. It felt these alternatives would provide consumers with more care information and greater choice, facilitate the introduction of new products, and maintain and increase competition in the affected industries. Specifically, the Council suggested that:

1. Permanently attached labels not be required for intermediate textile products or for every category of carpets and rugs.

2. Care instructions be simplified and related to current consumer care practices.

3. The responsibility for providing care information on piece goods be shifted from producer to retailer.

4. Additional institutional buyers be allowed to waive their "right" to care labeling.

MONITORING THE PRIVATE SECTOR

The Council's responsibility to identify and analyze inflationary influences in the private sector extends to long-term structural factors that may affect price and wage movements, as well as to specific price increases.

In its pricing studies, the Council's Office of Wage and Price Monitoring investigates capacity, profit, price, demand, and supply conditions in individual industries or sectors. It also analyzes structural features and changes in the general economic environment -- industrial concentration, noncompetitive practices, comparative price behavior, and other factors -- that may affect the performance of the economy with respect to prices. These studies are used, where appropriate, to urge firms to exercise price restraint.

In monitoring wages, the Office cooperates with labor and management to improve the structure of collective bargaining. It also conducts general wage studies and strives to improve wage data bases in both the public and private sectors of the economy.

A summary of the studies completed and released this quarter follows. Previous studies of private sector activities are summarized in the Council's Quarterly Report of April-June, 1976. A description of the Council's current studies, under way but not yet completed, may be found in Chapter III of this Quarterly Report.

Price Monitoring

Chlorine, Caustic Soda Prices

Early in 1975, the Council began to monitor a number of industrial chemicals whose prices had increased substantially in 1974. The prices of these chemicals remained well above costs, as demand increases pushed production to capacity levels. The result was a 30.8 percent

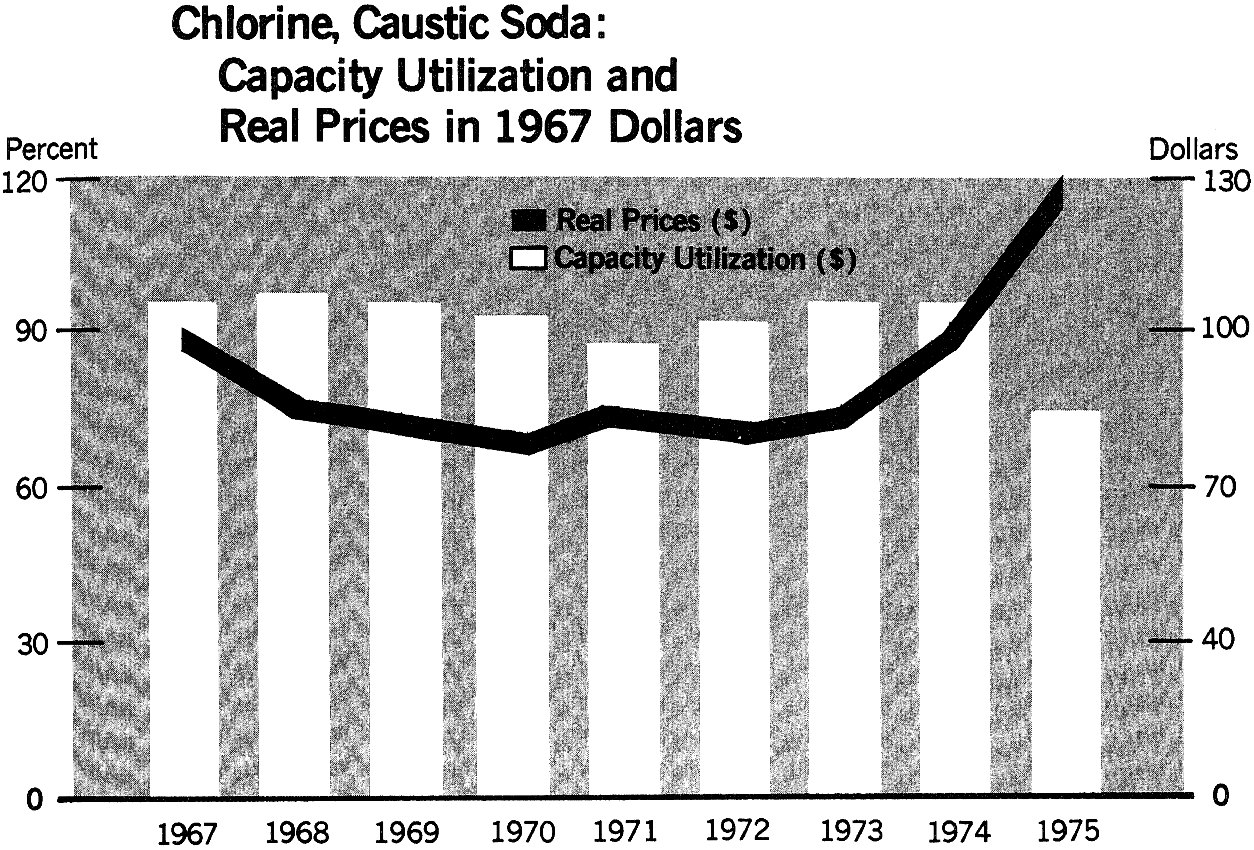
increase in the profits of chemical companies from 1973 to 1974. In late 1974, economic conditions in the chemical industry began deteriorating. However, despite substantial idle capacity, the average realized prices of two of the largest volume inorganic chemicals -- chlorine and caustic soda -- rose 20 percent (between December 1974 and May 1975).

In June 1975, Dow Chemical, a major producer, announced further list price increases of 6 to 7 percent for caustic soda, and other producers quickly followed suit. The apparently substantial profit margins realized on these products in 1974, together with the depressed demand conditions of early 1975, did not appear to justify further price increases, and the Council initiated a more detailed investigation into the pricing of these two industrial chemicals. Data on prices, costs, production, and inventories were submitted to the Council by several manufacturers, and these data were supplemented with information from trade associations and government agencies.

Chlorine and caustic soda are coproducts, and their output relationship is relatively fixed. Hence, market conditions for one necessarily affect the economics of producing and selling both. The production of chlorine and caustic soda has become increasingly concentrated in recent years. In 1963, the leading four firms accounted for 54 percent of industry shipments and by 1975, these four firms accounted for 64 percent of total industry output. This concentration is greater than for the average manufacturing industry, and it is above the average four-firm concentration ratio in chemical industries, which was 46 percent in 1972.

Considerable vertical integration is present in the industry. About 55 percent of chlorine produced is consumed in plants owned and operated by chlorine manufacturers. There are sizeable economies of scale in chlorine production, and an efficient size plant will supply 8 percent or more of the limited merchant market for chlorine. With demand for chlorine inelastic, the entry of an efficient size merchant plant into the industry will substantially depress prices. For that reason, entry is probably limited to existing, fully integrated chemical companies with a ready, internal market for part of the chlorine. In addition, it is unlikely that imports of chlorine can provide an effective alternative to domestic supplies.

The behavior of real prices and capacity utilization rates in the industry are shown in the figure below for the period, 1967 to 1975. Since 1973, average realized prices (essentially, a weighted transactions price) for both chemicals have risen substantially. In part, this increase was due to the sharp rise in the cost of energy.



Except for the recent 1974-75 contraction, capacity utilization in the chlorine caustic soda industry has been remarkably high compared to all manufacturing. Between 1960 and 1970, chlorine capacity doubled in response to strong demand for its use in plastics and other materials. The new capacity was fully utilized and manufacturers' prices fell rather consistently throughout this period. The sharp increase in prices in 1974 was in response to strong demand conditions that year.

In 1975, there was a sharp downward break in the rate of capacity utilization as production rates fell and inventories accumulated, but the average realized prices of chlorine and caustic soda continued to rise. This price increase was obviously not related to demand pressures. It also did not appear to be related to comparable manufacturing cost increases. Prices increased 90 to 94 percent between the first quarter of 1974 and the first quarter of 1975, while manufacturing costs increased only 37 percent over the same period.

The ability of chlorine, caustic soda producers to raise the market prices of these products during the 1974-75 recession provides evidence that industrial structure can allow producers to adjust price-cost margins upward in the face of falling short-term demand. The four largest chlorine manufacturers survived the 1974-75 recession with very little erosion in overall profit rates. The Council staff estimates that the net after-tax profit margin for chlorine, caustic soda was 26.6 percent in 1975.

The critical question is whether the rate of return on investment in new facilities (at current reproduction costs) is sufficiently high to attract new investment as demand increases. If not, the 1975 price increases will be followed by further increases as capacity level production is attained. As the table below indicates, the 1975 net after-tax return on chlorine, caustic soda investment estimated by the Council staff was well above the return on book value of assets for all operations of chlorine producers and for all manufacturing.

AFTER-TAX NET RETURNS ON ASSETS

Rate of Return on:	Rate of Return (%)
Replacement Cost of Chlorine, Caustic Soda Assets	20.8 - 23.7%
Book Value of Total Assets for all Operations of Chlorine Producers	10.7%
Book Value of Total Assets for all Manufacturing (FTC data)	7.6%

These estimates provide strong evidence that prices are well above cost and that the return on new investment in chlorine, caustic soda facilities is more than sufficient to attract funds for replacement capital. In addition, substantial internal funds -- estimated at $310.4 million in 1974 -- are available for financing new facilities.

The profitability of the chlorine, caustic soda industry must be viewed as either temporarily high while new sources of competitive supply are put in place or as the result of the high and rising concentration in the industry. Substantial capacity expansions and/or modernizations are currently underway, and these should place downward pressure on prices and profit margins over the next three to five years, *if* the industry behaves competitively. By mid-1976,

some weakness in caustic soda prices had appeared, but chlorine prices remained strong despite the failure of the industry to achieve capacity utilization rates as high as the lowest rates of the late 1960s-early 1970s.

Health Care Prices

During late 1975 and early 1976, the Council became concerned about the rapid escalation of prices in the entire health sector. The medical care services component of the Consumer Price Index rose 11.6 percent during the six-month period ending in May 1976, compared with 6.9 percent for all other services. Drug and prescription prices, which have rarely increased more than 1 percent annually, rose 6.9 percent over this same period. The Council is making an effort in several directions to analyze the reasons for the steep rise in health care prices.

Staff Report on Health Care Costs

In March 1976, the Council circulated widely the draft of a staff report on increases in health costs. Extensive comments were received, and the final report was issued on April 26th. The report documented the extent of inflation in health care services and assessed its impact on consumers, labor, industry, and government. It also examined the unique structural characteristics of the industry -- the prevalence of third-party payments, health insurance financing, high levels of government support, the physician's role, and the rapid pace of technological change.

The study found that health care prices have been increasing much faster than other prices in the economy due to several factors: improvement in the quality of services provided, the "bulge" effect following the ending of wage and price controls in April 1974, and sharp increases in factor costs. The structure of the health industry also contributes to long-run upward price pressures; demand is boosted by third-party payments that obscure the impact of health expenditures on household budgets, and incentives to reduce costs and improve efficiency are weak. Although benefits are difficult to calculate, indications are that large additional expenditures on medical care may be a high-cost way of improving national health.

During the preparation of the Council study, it became apparent that union and management officials are becoming increasingly alarmed over the escalating cost of employee health care benefits. Many innovative efforts are being made within the private sector to deal with this problem, but little was known about these programs, scattered as they are across the country.

The Council, feeling that corporate and union officials might profit from knowledge of what their colleagues were attempting in this field, held a series of three public hearings addressed to the problem of rising health care costs. The hearings highlighted specific programs instituted by employers, unions, providers, insurers, and others to curtail these costs. The hearings were held in New York on June 20-21, in Chicago on July 20-21, and in San Francisco on August 10-11 of 1976.

On September 17, pursuant to these hearings, the Council released a report comprising six case studies describing in detail some innovative techniques on the part of the private sector for dealing with medical care inflation and the rising cost of benefit programs; a compendium to the report lists another 119 projects, organized by type of innovation and alphabetized within each section under the sponsoring union or employer.

The innovations cited in the case studies suggest the potential power of labor and management to combat medical care inflation and the rising cost of benefit programs. For example:

- The second opinion programs for elective surgery initiated by the United Storeworkers Union and the American Federation of State, County and Municipal Employees, District Council 37, both of New York City, effected a 9.4 percent reduction in elective surgery for the storeworkers and a 4.4 percent decrease for District Council 37. This provides substantial savings through reduced hospitalization.

- Prospective review of dental care offered by the United Federation of Teachers Welfare Fund (New York) to its members afforded the fund a savings of $1.04 million in dental benefits in 1975. Moreover, the dental review programs, predetermination and alternate course of treatment, reduce premiums for employees by 4.8 percent.

- The UFT Fund and the International Ladies' Garment Workers each sponsor a prescription drug program. The UFT Fund's contracts with pharmacists enable it to control the retail mark-up. The program pays an estimated 10-15 percent less than the retail market price. The ILGWU's order plan provides prescription drugs to members at a significantly lower cost. Cost savings are achieved through economies of scale due to the large volume of orders processed.

- Rockwell International reports a significant amount of "cost-avoidance" in health benefit claims due to its claims review program.

- Goodyear Tire & Rubber Company attributes substantial savings in reduced benefit costs to its cost control efforts through self-insurance and claims review. The company sees great potential savings from eliminating unnecessary and inappropriate utilization of services. To this end, Goodyear actively participates in community health planning and sponsoring peer review programs.

- The creation of the Genesee Valley Group Health Association, a prepaid group practice in Rochester, New York, was supported by Eastman Kodak, Xerox, Sybron, General Motors, and other companies. Local HMO members experienced a 7 percent <u>reduction</u> in medical-surgical inpatient days in 1974, versus a 5 percent <u>increase</u> for local beneficiaries with traditional indemnity coverage. Moreover, the rise in HMO plan family premiums since 1973 is the lowest among the four Genesee Valley area Blue Cross-Blue Shield affiliated plans.

The Council's report is intended as a resource or guide as to what can and is being done to control costs and how to find out more about these efforts. It makes no pretense of providing the ultimate solution to health care inflation. The response to the Council's report indicates a widespread need for information on new programs, and to this end the Council has scheduled another series of three public hearings on the same issues. These are being held in Philadelphia on October 14, in Houston on October 21, and in Miami on October 28. A report highlighting testimony given at the full set of hearings in six cities will be published later this Fall.

In addition, the Council has embarked on two additional studies of inflation in the health care sector, one focusing on hospital costs to be completed by Professor Martin Feldstein later this year and the other focusing on physicians' fees being done by Council staff and expected to be completed early in 1977. Both will examine in great detail, using data sources heretofore not available, the extent of and cause of inflation among various categories of hospitals and physicians.

Aluminum Prices, 1974-75

In January 1975, domestic aluminum producers announced plans to curtail production of primary aluminum. Further cutbacks occurred throughout the spring, but there were no announcements of price decreases on primary aluminum. In fact, in late June and early July 1975, the major producers announced a price increase for primary metal and a set of mill products even though aluminum shipments remained low. This price behavior contrasts sharply with the post-recessionary price behavior of the industry in 1971-72, when widespread discounting resulted in a 14 percent reduction in the list price of primary aluminum in 1972.

This departure from previous pricing patterns prompted the Council to undertake a major study of pricing structure in the aluminum industry. The study, begun in January 1975 and completed in September 1976, focused on four topics:

1. The ability of aluminum producers to maintain, and then increase, prices in the face of deteriorating market conditions during the 1974-75 period.

2. The structure of the aluminum industry and the effect of this structure on price behavior.

3. Aluminum company profitability.

4. The implications of various industry practices for efficient resource allocation.

The aluminum industry has a long history of concentration attributable to a combination of several factors: relatively high capital costs, patent rights, economies of large scale, monopoly or near-monopoly control of raw materials, and government protection and/or encouragement. The industry began as a monopoly and was transformed by government action into a three-firm oligopoly shortly after World War II. Following the Korean War, units of major foreign producers and a competitive fringe of smaller firms were added to the industry.

The new entrants have reduced concentration substantially in the last 35 years. Witness, for example, the declining share of primary aluminum ingot capacity held by Alcoa during this period: from 100 percent in 1940 to 49 percent in 1950, to 35 percent in 1960, to 31 percent in 1970 and rising slightly to 32 percent in 1974. The market share of Alcoa, Reynolds, and Kaiser has fallen from 100 percent in 1950, to 88 percent in 1960, to 71 percent in 1970 and

and 67 percent by the end of 1974. Nevertheless, the domestic and world industry remains much more concentrated than most industrial markets and most metals markets.

Noncompetitive practices were examined in five different areas: (1) nonprice allocation during shortage, (2) the use of a uniform delivered price system, (3) the use of scrap buy-back and toll conversion arrangements, (4) participation in joint ventures, and (5) price squeezing. Of these practices, the use of uniform delivered pricing and the prevalence of joint ventures are the most obvious obstacles to the development of vigorous competition.

The primary aluminum market was characterized by the following behavior during the recession of late 1974 and 1975: production was reduced, employment was down, and prices held firm and then were increased. A similar pattern was observed at the mill product stage. In the secondary aluminum industry, which has a market structure resembling a competitive industry, deteriorating markets were accompanied by declining prices.

Given the small number of large firms and little or no product variation, industry cohesiveness with respect to price leadership might be the logical outcome of each firm pursuing a noncollusive, but parallel, pricing policy. However, neither the entry of a number of small firms into ingot production nor the appearance of substantial excess capacity starting in mid-1974 led to immediate discounting; although there is some evidence of discounting after April 1975, the list price structure did not break and, in fact, list prices were increased in August 1975.

Although this price behavior of 1974-75 was quite different from that of the 1971-72 period, the study found that the difference was not due to any marked change in industry structure. Rather it appeared to result from a combination of the following factors:

1. Stockpile purchases at list price were to be made in 1972 but not during 1975.

2. Variable costs had risen more sharply during 1973 and 1974, both in total and as a percent of total costs per unit, thereby weakening the gain from discounting.

3. The experience with price controls and the concern that they might be reinstituted made price reductions less likely during 1975.

4. Recognition of the profit depressing effects of price discounting during 1971-1972 was widespread.

5. As a result of the shortages of 1973 and 1974, buyers were more concerned about assured sources of supply and were thus less aggressive in seeking lower prices.

6. Buyers held considerable excess inventory at the onset of the 1975 recession as a result of their attempts to protect themselves during the preceding non-price allocation period. Hence, short run price elasticity of demand was probably lower than usual.

Aluminum company profits were examined and compared with other groups in the economy. Several statistical calculations were made on the basis of accounting data provided by the aluminum companies, and these were summarized into measures of the return on invested capital and of cash flow as an indication of payout capability.

The measures of return on total invested capital shows that the major firms in the aluminum industry (Alcan, Alcoa, Reynolds, and Kaiser) earned lower rates than other metals producers (except steel producers in some years) during the period from 1965 through 1974. In fact, both measures show a ten-year average for the total return on invested capital for aluminum that is only 64 percent of the ten-year average for a group of 425 industrials. The relatively high level of concentration has not yielded high rates of return. It should be remembered, however, that market power can be manifest in numerous practices at the same time that return on capital may be restrained by excessive growth of capacity and interindustry rivalry in end-use markets. During the 1965-75 period, cash flow as a percent of stockholders' equity in the aluminum industry averaged approximately 92 percent of the rate of cash flow for all manufacturing and 113 percent of the rate for all primary nonferrous metals. If there is a tendency to overstate depreciation and depletion in the companies' income statements, this would suggest that there may be downward bias in reported rates of return.

These rates of return suggest that the aluminum industry will have some difficulty in raising capital for expansion until profitability is restored. Growth of primary aluminum capacity in the noncommunist world will likely take place outside of North America, with minor exceptions, and probably will be in the form of joint ventures that involve combinations between one or more of the six major aluminum companies and host governments.

Wage Monitoring

Major Collective Bargaining Settlements, 1976

The Council has a continuing interest in the issues and results of major collective bargaining negotiations. In January 1976, the Council published a background paper examining the structure of bargaining and the pattern of previous wage settlements in the construction, automobile, trucking, electrical, rubber, apparel, retail food, and meat packing industries. The paper traced trends in wages, benefits, labor costs, employment, and productivity for the past few years, and it analyzed the financial condition of the companies.

The Council's concern goes beyond the internal effects of settlements on a particular industry, because those in key industries may affect the performance of the rest of the economy in at least two ways. First, if prices in one industry increase as a result of a new settlement, costs in other industries which buy the good or service in question will rise. Second, compensation or price increases may have a demonstrative effect on wages and prices in other industries.

On September 24, the Council issued reports analyzing the results of settlements in three major industries: trucking, electrical equipment, and rubber. Employee compensation increases in these industries were examined in five parts:

1. Negotiated annual wage increases.
2. Cost-of-living adjustments.
3. Improvements in employee health, welfare, and pension benefits.
4. Other fringe benefit improvements.
5. Increases in the cost of providing existing benefits.

The impact of higher wages and benefits on prices and profits depends on the relationship of changes in employee compensation costs to changes in labor productivity or the net change in unit labor costs, on the ratio of labor costs to total costs, and on the degree of competition in the industry.

Trucking. The National Master Freight Agreement directly affects pay and benefit increases for about 440,000 Teamsters; in addition, it has an impact on about 250,000 Teamster members working under local agreements, about 250,000 nonunion trucking workers, and workers in

other industries employing Teamster members. From February 1966 through February 1976, the Consumer Price Index rose about 74 percent, while average hourly earnings of drivers and platform men rose 104 percent. During the last three years, however, the increase in the CPI was slightly greater than that of Teamster hourly earnings. As the 1976 negotiations began, Teamsters working under the Master Freight Agreement were among the highest paid hourly workers in the economy.

The 1976 three-year agreement provided for an average annual wage increase of 7.2 percent, or 23.0 percent in total; the increase for truckers paid by the mile was somewhat less. As in previous agreements, an escalator clause geared to the CPI was included, but in this agreement, the "cap" -- or annual maximum -- was removed from the provision; the clause provides for an increase of one cent per hour for every 0.4 rise in the CPI during 1976 and one cent for every 0.3 rise in living costs thereafter. In addition, employer payments into health, welfare, and pension funds were increased by $17 per week over the three years. In all, the increase in wages and benefit fund contributions averages about 10 percent annually over the three-year life of the contract, assuming a 6 percent annual rate of inflation. A variety of new fringe benefits and improvements in working conditions, as well as the rising cost of existing benefits, will also add to employer costs.

Although labor productivity in trucking will probably not increase as much as employee compensation, the first-year increases provided by the agreement are not likely to increase the present rate of inflation. The effects in the two subsequent years depend on productivity changes and cost-of-living increases during this time, but it is unlikely that increases in trucking wage rates, per se, would have much direct effect on the rate of inflation. However, some indirect inflationary pressure may result from the influence of higher second and third-year increases -- or "backloading" of the contract -- on other major settlements in which uncapped cost-of-living increases are added to negotiated wage gains.

Electrical Equipment. Collective bargaining settlements with General Electric have tended to set the pattern for the other industry leader, Westinghouse, and hence, for most of the industry. A combined total of 167,000 workers in the two firms is covered by their contract with a coalition of unions headed by the International Union of Electrical Workers and the United Electrical Workers. Average hourly earnings of workers in the industry rose about 10 percent more than the CPI from March 1966 through March 1976, but increases have been about equal during the last three years of this period.

Wage increases under the 1976 three-year agreement amount to about 23.0 percent with more than half of the total increase coming in the first year. There is no "cap" on the cost-of-living clause in the new agreement, and -- assuming a 6 percent inflation rate -- the average annual increase in wages would amount to 9.9 percent; however, the actual increase in the first year would be almost 15 percent. The new contract also provides improvements in a number of benefit provisions, including vacations, pensions, and health and welfare, but cost information on these items was not available.

Assuming that productivity in the industry is increasing at a rate of about 4 percent annually, the net increase in labor costs would raise total unit costs by 5 percent or more over the next year. This would put upward pressure on prices of household electrical appliances and heavy industrial equipment if profit margins are maintained.

Rubber. Collective bargaining in the rubber industry occurs at the local level between the United Rubberworkers Union and five major companies -- Goodyear, Firestone, Uniroyal, B. F. Goodrich, and General Tire and Rubber. In the past, the union has selected a target company and sought to establish a pattern settlement. Negotiations cover about 70,000 workers, and other workers are under separate contracts. From April 1966 through April 1976, the CPI increased about 13 percent more than wage increases in the rubber industry, and it rose about twice as much during the latest three years of the period. Although productivity and profits were recovering during the first quarter of 1976, a strike closed the plants down in April 1976.

The new three-year contract provides an average annual wage increase of 8.7 percent, with more than half of the total increase coming in the first year. It also contains the first cost-of-living clause for rubberworkers. Assuming an average 6 percent annual increase in the cost-of-living, the combined wage and cost-of-living increases would average 11.7 percent annually during the three-year period -- the largest of any major settlement this year. The new agreement also provides a number of benefit improvements, especially in pension plans. Adding to this the "roll-up" cost of wage-related benefits, such as holidays, sick leave, and vacations, the total increase in wages and benefits is about 10 percent per year.

Assuming a 4 percent annual increase in productivity, the net increase in labor costs will raise unit total costs by 5 percent or more over the next year. However, rubber products are a relatively small component of both Wholesale and Consumer Price Indexes, so this increase should have relatively little effect on the overall rate of inflation.

CHAPTER III

STUDIES IN PROGRESS

In continuing its program of monitoring price and wage trends and the inflationary potential of government activities, the Council has a number of studies in progress. Reports on many of these will be completed and released during the final quarter of 1976.

INDUSTRY PRICE BEHAVIOR

Automobiles

Auto Prices

In October, the Council will release a report on price increases for the 1977 model cars produced by the four major domestic automobile manufacturers. A similar investigation of price increases in 1976 model automobiles was released in November 1975. The current study will be based on data submitted to the Council by manufacturers. An econometric model will be employed to calculate wholesale price increases for 1977 model cars, and the analysis will compare these price changes to cost increases. Measures of profitability will be estimated based on these price-cost relationships.

Auto Parts

On February 18, 1976, the Council announced an investigation of increases over the last two years in the prices of automobile replacement parts. Measured by the wholesale price index for auto parts--a composite index for original equipment parts and for replacement parts--prices increased 23.8 percent in 1974 and by another 9.9 percent in 1975. For the same periods, the wholesale price index for new cars increased by 12.9 and 6.0 percent, respectively. Data provided to the Council by several automobile insurance companies revealed that the most rapidly rising prices were those for crash replacement parts; prices for maintenance parts have been rising less rapidly in the last year.

The Council decided that an in-depth investigation of these price increases was required. While the investigation will focus on crash parts, it will also include maintenance parts prices. Price and cost data are being collected to analyze the causes of increases in these prices. The automobile manufacturers have submitted price information for each year since 1971 on all replacement parts sold by them. The Council staff has compiled samples of both crash and maintenance parts prices for analysis, and the automobile

manufacturers have also been requested to supply cost and quantity information for those parts. Independent parts manufacturers have provided information regarding the parts they produce for both the original equipment and replacement markets and have been requested to provide information on prices and costs for selected parts.

Food

Farm/Retail Food Price Relationships

The Council will publish a report on the relationship between farm level prices and the wholesale and retail prices of food products. The report will address the following questions:

> Is the farmer's share of the food dollar rising or declining?
>
> Are processing and distribution margins increasing more rapidly than the costs of performing these functions?
>
> Does market concentration in food processing, wholesaling, and retailing explain changes in margin levels or in the response of prices to change in underlying cost conditions?
>
> Do food prices respond more rapidly to commodity price increases than to commodity price decreases?
>
> Have food prices become less sensitive to changes in processors' and distributors' costs in recent years?

The report will examine the economic environment in which food prices are determined, detail the history of movements of farm-retail price spreads since 1960, and investigate market concentration in food processing and distribution. In addition, the report will summarize the results of an econometric study conducted by Dr. Dale Heien of how changes in key input prices (commodities, labor, transportation, and so forth) are reflected in wholesale and retail prices for thirty finished food products.

Cereal and Bakery Products

In April 1975, the Council began an investigation into prices of cereals and bakery products. The wholesale and retail prices of these products had been slow to respond to large reductions in the prices of flour, wheat, corn, sugar, shortening, and milled rice. The Council's preliminary findings were released in January 1976, along with an announcement that a more comprehensive study was being

launched. The preliminary analysis concluded that the combination of rising profit margins and considerable economic concentration in the cereal and breadbaking industries raised doubts as to whether commodity cost savings are being reflected in retail prices. Separate final reports will assess the degree of responsiveness of cereal and bread prices to variations in ingredients costs over the 1973-75 period.

Health Care

Health Care Hearings

The Council is continuing its series of health care hearings on the causes of inflation in the health care industry and on the various efforts at cost control being undertaken in the public and private sectors. A report on the first round of hearings was issued in September 1976 (see p. 20 of this Quarterly Report). In the current round, hearings are scheduled to be held in Philadelphia, Houston, and Miami through the month of October. At the end of the year, the Council will publish a report summarizing the findings of these hearings.

Hospital Charges

Because of concern over rapidly rising hospital charges, the Council, on June 5, 1975, commissioned a hospital industry price and wage study to be done by Martin Feldstein, Professor of Economics at Harvard University, who has written extensively on health care economics. The study will consist of three separate but closely related parts: (1) a general analysis of hospital cost and wage increases during the past decade; (2) an economic and statistical analysis of hospital costs based on observations for each state; and (3) a microeconomic analysis of a sample of individual hospitals.

Metals

On April 30, 1976, the Council announced that it was undertaking a comparative study of recent price behavior in the steel, copper, aluminum, lead, zinc, and magnesium industries. The Council said it would review recent trends in production, shipments, inventories, orders, costs, gross margins, imports, and import prices. The purposes of the study are to analyze the factors underlying recent price increases and to determine whether the timing and magnitude of these increases are consistent with price movements occurring during earlier recovery periods. The Council has requested relevant data from the various producers of these metals and will make its findings public as it completes its studies.

Construction

The Council is undertaking a study documenting the extent of cost increases in the nonresidential construction industry in recent years. The study will attempt to sort out the relative importance of various factors such as labor costs, materials prices, and equipment prices and will analyze the impact of construction cost increases on business investment.

Industrial Capacity

The Council is nearing completion of a study of paper prices following its public hearing held on May 18, 1976. This report will represent the first of a series of studies on the adequacy of industrial capacity, investment behavior, and the implications of these factors for future price movements. The second study in this series will focus on industrial capacity in the textile and cement industries. The studies will attempt to identify the determinants of capital investment, the inflation in product prices required to attract capital, and specific problems related to undertaking new investment projects.

GENERAL PRICE STUDIES

Price Measurement

One of the mandates given to the Council is to improve wage and price data bases for the various sectors of the economy. In its studies, the Council staff has encountered many problems with the Wholesale Price Index (WPI). These problems were noted in a speech by the Council Director on May 20, 1975, at which time a study of the adequacy of the WPI for wage/price monitoring was announced. The study, conducted by Yale University Professor Richard Ruggles through the National Bureau of Economic Research, will examine such issues as the redundancy and the gaps in the WPI and the extent to which WPI prices reflect actual transactions prices. A final report will be issued in January 1977.

Recession Prices

The Council is completing a new report which extends and refines its earlier study on the behavior of prices during the 1974-75 recession and the effect of industrial concentration on the cyclical responsiveness of prices. The first report, released on May 11, 1976, indicated that (1) prices were less responsive during the recent recession than during previous downturns, (2) rates of price change varied at different stages of the recession, (3) there

is some limited but not clear-cut evidence that prices in concentrated industries are somewhat less responsive to reduced demand than those in unconcentrated industries. The new study will address the effects of energy and commodity price escalation and will further investigate responses to demand variation.

Stage-of-Process Price Behavior

The Council has commissioned the National Bureau of Economic Research, with Dr. Joel Popkin as principal investigator, to develop a quarterly model of price behavior by stage-of-process for the industrial sector of the economy. The research is centered on price relationships for intermediate and finished goods production in each of eight primary manufacturing industries: textiles, lumber, paper, chemicals, fertilizer, nonferrous metals, and stone, clay and glass. Dr. Popkin has completed the first third of the project, which provides econometric estimates of price behavior in the primary (crude) materials sectors, and he will provide further research results to the Council as they become available. The Council staff is currently investigating the possibility of extending these results to more detailed price studies.

WAGE STUDIES

Public Sector Employee Compensation

In October, the Council will publish a report documenting data deficiencies in the area of compensation of state and local government employees. The report compares available federal government data for private and public sector workers and makes several recommedations as to how public sector data might be made more comparable to that for the private sector. The Council finds that there is insufficient information on (1) the cost of employee benefits--a necessary ingredient for calculations of total compensation, (2) comprehensive measures of earnings, (3) measures of changes in earnings, and (4) collective bargaining settlements in the state and local sector.

PUBLIC SECTOR STUDIES

Effect of Government Regulation

It has been apparent for some time that the steel industry is substantially affected by Federal regulations. On February 25, 1976, the Council announced the initiation of a joint study with the National Productivity Center of the economic impact of federal regulation of the domestic iron and steel industry. The Council's study

represents the first time that an agency of the federal government has examined the total impact on a particular industry of all government regulations, with emphasis on the aggregate benefits and aggregate costs which result from the application of those regulations.

In an effort to document Federal regulations of the steel industry, the Council in April began compiling a catalog of the Federal regulations that significantly affect the industry. The heart of the catalog will consist of 8-10 chapters outlining major areas of regulatory impact (e.g., environmental practices). Each chapter will describe the particular regulatory scheme and will identify and discuss particular regulations affecting the iron and steel industry. The catalog will identify those regulations particularly affecting the industry which were subjected to cost-benefit analysis. In addition, the catalog will help to identify major areas of Federal regulatory overlap and to draw comparisons between different regulatory approaches.

Existing estimates of the costs and benefits of compliance with these regulations will be summarized and critically appraised in a second study paper. A significant portion of this paper will be devoted to the development of an appropriate methodology for analyzing the economic impact of Federal regulations in the steel and other industries.

Inflation Impact Statement Program

The Council, along with the Office of Management and Budget, has invited comments on the Inflation Impact Statement Program as part of their appraisal of this program. The IIS program is scheduled to terminate on December 31, 1976, and the current appraisal is directed toward developing recommendations as to whether it should expire, be extended as is, or be modified. The study will focus on the following areas:

1. The quality of IIS analyses.
2. Whether all important legislative and regulatory proposals are being analyzed.
3. Whether the IIS analyses should be made available to the public and, and for those that have been, if it has been helpful to the public and to the agency making the decisions.
4. The impact, if any, of the IIS program on the drafting of legislation, rules and regulations. (Has it caused significant delays?)

5. The impact of the program on the quality of legislation, rules and regulations.

6. The direct costs of the program over and above usual agency expenses.

7. Alternatives to the IIS program, such as a legislative mandate for agencies to review costs and benefits.

APPENDIX A

Council Members

The Council consists of eight members and four adviser-members appointed by the President. The Council has a full-time staff headed by a Director who is appointed by the President, with the advice and consent of the Senate. On May 18, 1976, William Lilley III, formerly Deputy Director became the Acting Director succeeding Michael H. Moskow, who went to the Department of Labor as Under Secretary. The current Council membership and the principal staff officers are listed in Chart I.

Council Organization and Staffing

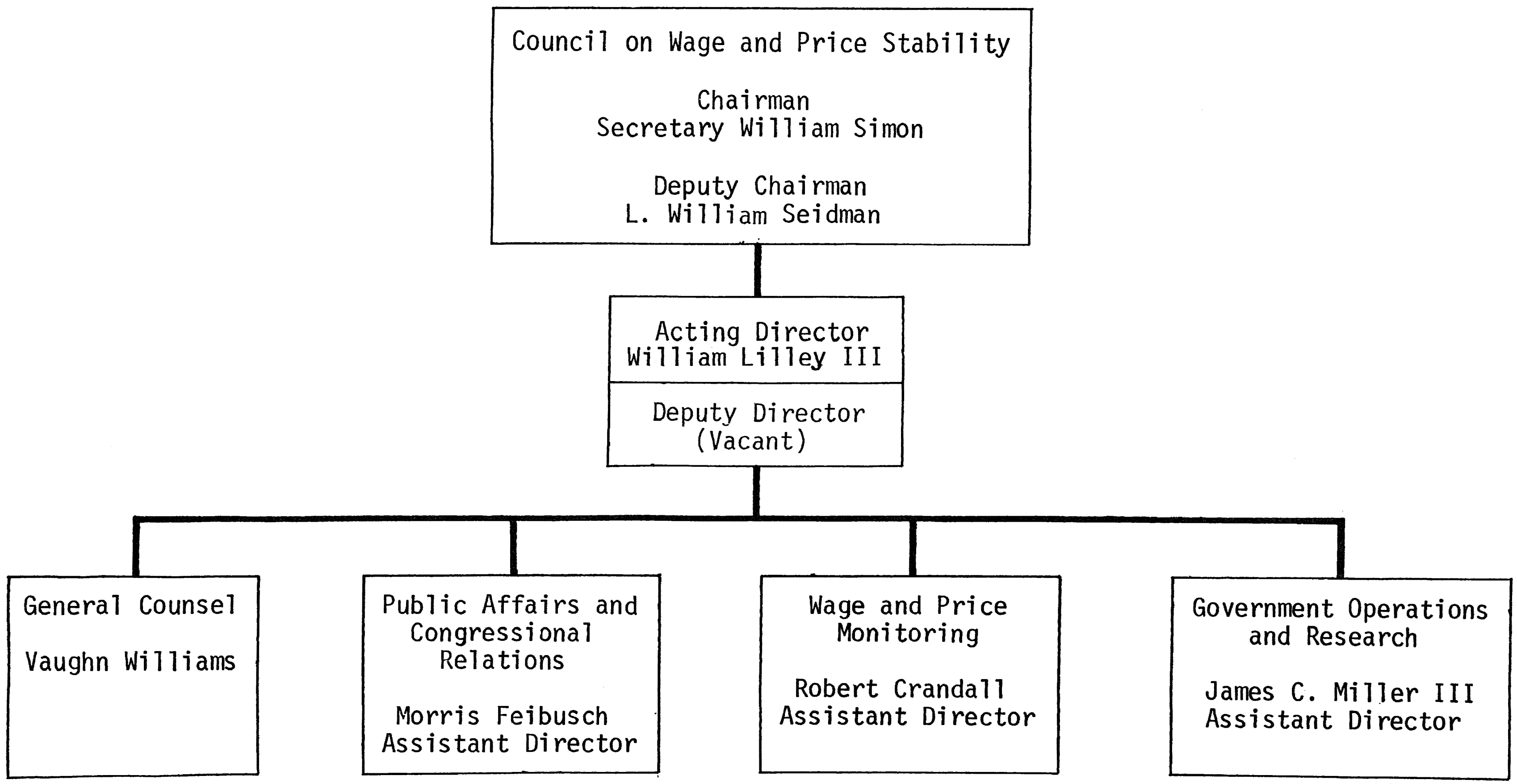
The Council's staff is organized into five units: (i) the immediate Office of the Director, (ii) the Office of Wage and Price Monitoring, (iii) the Office of Government Operations and Research, (iv) the General Counsel's Office and (v) the Office of Public Affairs and Congressional Relations. As of September 30, 1976, the Council's total staff was 56, including 38 professionals, most of whom are economists.

The Council on Wage and Price Stability Act authorizes a $1,7000,000 budget for the Council's operations during each of fiscal years 1976 and 1977. For fiscal year 1976, $1,550,000 has been appropriated for the Council's operations. For fiscal year 1977, $1,607,000 has been requested. This amount will allow the Council to continue its activities at the same level as in the past.

Council on Wage and Price Stability

Chairman	William E. Simon Secretary of the Treasury
Deputy Chairman	L. William Seidman Assistant to the President for Economic Affairs
Acting Director	William Lilley III
Members	
Secretary of Agriculture	John Knebel (Acting)
Secretary of Commerce	Elliott L. Richardson
Secretary of Labor	W. J. Usery, Jr.
Director of the Office of Management and Budget	James T. Lynn
Special Representative for Trade Negotiations	Frederick B. Dent
Special Assistant to the President for Consumer Affairs	Virginia H. Knauer
Adviser Members	
Assistant Secretary (Planning and Evaluation), Department of Health, Education and Welfare	William A. Morrill
Assistant Attorney General Antitrust Division	Donald I. Baker
Deputy Secretary of Transportation	John W. Barnum
Deputy Administrator of Environmental Protection Agency	John R. Quarles

COUNCIL ON WAGE AND PRICE STABILITY



APPENDIX B

The Council on Wage and Price Stability Act,
Public Law 93-387 (August 24, 1974) as amended
by Public Law 94-78 (August 9, 1975)

AN ACT

To authorize the establishment of a Council on Wage and Price Stability

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Council on Wage and Price Stability Act".

Sec. 2 (a) The President is authorized to establish, within the Executive Office of the President, a Council on Wage and Price Stability (hereinafter referred to as the "Council").

(b) The Council shall consist of eight members appointed by the President and four adviser-members also appointed by the President.

(c) There shall be a Director of the Council who shall be appointed by the President by and with the advice and consent of the Senate. The Director shall be compensated at the rate prescribed for level IV of the Executive Schedule by section 5315 of title 5, United States Code. The Director of the Council shall perform such functions as the President or the Chairman of the Council may prescribe. The Deputy Director shall perform such functions as the Chairman or Director of the Council may prescribe.

(d) The Director of the Council may employ and fix the compensation of such officers and employees, including attorneys, as are necessary to perform the functions of the Council at rates not to exceed the highest rate for grade 15 of the General Schedule under section 5332 of title 5, United States Code. Except that the Director, with the approval of the Chairman may, without regard to the provisions of title 5, United States Code, relating to appointments in the competitive service, appoint and fix the compensation of not to exceed five positions at the rates provided for grades 16, 17, and 18 of such General Schedule, to carry out the functions of the Council.

(e) The Director of the Council may employ experts, expert witnesses, and consultants in accordance with the provisions of section 3109 of title 5, United States Code, and compensate them at rates not in excess of the maximum daily rate prescribed for grade 18 of the General Schedule under section 5332 of title 5, United States Code.

(f) The Director of the Council may, with their consent, utilize the services, personnel, equipment and facilities of Federal, State, regional, and local public agencies and instrumentalities, with or without reimbursement therefor, and may transfer funds made available pursuant to this Act to Federal, State, regional, and local public agencies and instrumentalities as reimbursement for utilization of such services, personnel, equipment, and facilities.

(g) The Council shall have the authority, for any purpose related to this Act, to --

(1) require periodic reports for the submission of information maintained in the ordinary course of business; and

(2) issue subpenas signed by the Chairman or the Director for the attendance and testimony of witnesses and the production of relevant books, papers, and other documents, only to entities whose annual gross revenues are in excess of $5,000,000;

relating to wages, costs, productivity, prices, sales, profits, imports, and exports by product line or by such other categories as the Council may prescribe. The Council shall have the authority to administer oaths to witnesses. Witnesses summoned under the provisions of this section shall be paid the same fees and mileage as are paid to witnesses in the courts of the United States. In case of refusal to obey a subpena served upon any person under the provisions of this section, the Council may request the Attorney General to seek the aid of the United States district court of any district in which such person is found, to compel that person, after notice, to appear and give testimony, or to appear and produce documents before the Council.

Sec. 3 (a) The Council shall --

(1) review and analyze industrial capacity, demand, supply, and the effect of economic concentration and anticompetitive practices, and supply in various sectors of the economy, working with the industrial groups concerned and appropriate governmental agencies to encourage price restraint;

(2) work with lábor and management in the various sectors of the economy having special economic problems, as well as with appropriate government agencies, to improve the structure of collective bargaining and the performance of those sectors in restraining prices;

(3) improve wage and price data bases for the various sectors of the economy to improve collective bargaining and encourage price restraint;

(4) conduct public hearings necessary to provide for public scrutiny of inflationary problems in various sectors of the economy;

(5) focus attention on the need to increase productivity in both the public and private sectors of the economy;

(6) monitor the economy as a whole by acquiring as appropriate, reports on wages, costs, productivity, prices, sales, profits, imports, and exports;

(7) review and appraise the various programs, policies, and activities of the departments and agencies of the United States for the purpose of determining the extent to which those programs and activities are contributing to inflation; and

(8) intervene and otherwise participate on its own behalf in rulemaking, ratemaking, licensing and other proceedings before any of the departments and agencies of the United States, in order to present its views as to the inflationary impact that might result from the possible outcomes of such proceedings.

(b) Nothing in this Act, (1) authorizes the continuation, imposition, or reimposition of any mandatory economic controls with respect to prices, rents, wages, salaries, corporate dividends, or any similar transfers, or (2) affects the authority conferred by the Emergency Petroleum Allocation Act of 1973.

Sec. 4 (a) Any department or agency of the United States which collects, generates, or otherwise prepares or maintains data or information pertaining to the economy or any sector of the economy shall, upon the request of the Chairman of the Council, make that data or information available to the Council.

(b) Disclosure of information obtained by the Council from sources other than Federal, State, or local government agencies and departments shall be in accordance with the provisions of section 552 of title 5, United States Code.

(c) Disclosure by the Council of information obtained from a Federal, State, or local agency or department must be in accord with section 552 of title 5, United States Code, and all the applicable rules of practice and procedure of the agency or department from which the information was obtained.

(d) Disclosure by a member or any employee of the Council of the confidential information as defined in section 1905 of title 18, United States Code, shall be a violation of the criminal code as stated therein.

(e) Consistent with the provisions of section 7213 of the Internal Revenue Code of 1954, nothing in this Act shall be construed as providing for or authorizing any Federal agency to divulge or to make known to the Council the amount or source of income, profits, losses, expenditures, or any particular thereof, set forth or disclosed solely in any income return, or to permit any income tax return filed pursuant to the provisions of the Internal Revenue Code of 1954, thereof, to be seen or examined by the Council.

(f)(1) Product line or other category information relating to an individual firm or person and obtained under section 2(g) shall be considered as confidential financial information under section 552(b)(4) of title 5 of the United States Code and shall not be disclosed by the Council.

(2) Periodic reports obtained by the Council under section 2(g) and copies thereof which are retained by the reporting firm or person shall be immune from legal process.

Sec. 5. The Council shall report to the President, and through him to the Congress, on a quarterly basis and not later than thirty days after the close of each calendar quarter, concerning its activities, findings, and recommendations with respect to the containment of inflation and the maintenance of a vigorous and prosperous peacetime economy.

Sec. 6. There is hereby authorized to be appropriated not to exceed $1,700,000 for each fiscal year ending prior to October 1, 1977 to carry out the purposes of the this Act.

Sec. 7. The authority granted by this Act terminates on September 30, 1977.

APPENDIX C

INFLATION IMPACT STATEMENT PROGRAM

The Council plays a major role in the President's Inflation Impact Statement Program.* The purpose of this program is to encourage Federal agencies to take greater account of the economic effects of their proposals for major new rules, regulations and legislation. When such a proposal is major (in terms of its cost impact on consumers, business, or Federal, state or local governments; or its effect on productivity, competition, employment or energy) a full economic analysis (Inflation Impact Statement) must be prepared by the proposing agency. If the Inflation Impact Statement relates to a proposed rule or regulation, it is the Council's responsibility to review it. If the statement relates to proposed legislation, responsibility for its review belongs to the Office of Management and Budget.

Executive Branch agencies are required initially to submit to the Council only brief summaries of the economic impact of proposed major new rules and regulations. If, after reviewing these summaries, the Council has questions either about the summary or proposal itself, the Council may ask the agency to submit the complete economic analysis on which the summary was based.

After review of the agency's analysis, the Council may decide to make formal comments to the agency about the quality of its Inflation Impact Statement analysis and/or about the economic consequences of the regulatory proposal. It should be noted that criticism of an Inflation Impact Statment does not necessarily mean that the Council objects to the proposed regulation. It may mean simply that the Council thinks the agency should provide a better analysis of the regulation's likely economic effects. One of the Council's major aims is to help agencies improve the quality of their economic analysis so that important regulatory decisions are made with fuller awareness of their economic consequences.

Progress has been made in the administration of this program. In consultation with OMB and the Council, agencies have established criteria for identifying those proposals which are important enough to warrant an Inflation Impact Statement. Problems which were serious at the program's outset--particularly tardy compliance and uneven analytical quality--are gradually being resolved. While the Council has filed critical comments in a number of rulemaking proceedings, most agencies are making a commendable effort to analyze more carefully the major rules and regulations they issue.

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* Established by Executive Order No. 11821 issued November 27, 1974, and OMB Circular No. A-107, issued January 28, 1975.

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